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# INTERNATIONAL TAXATION

Second Term, 2000-2001

Instructor: J. Scott Wilkie

MATERIALS

VOLUME 1

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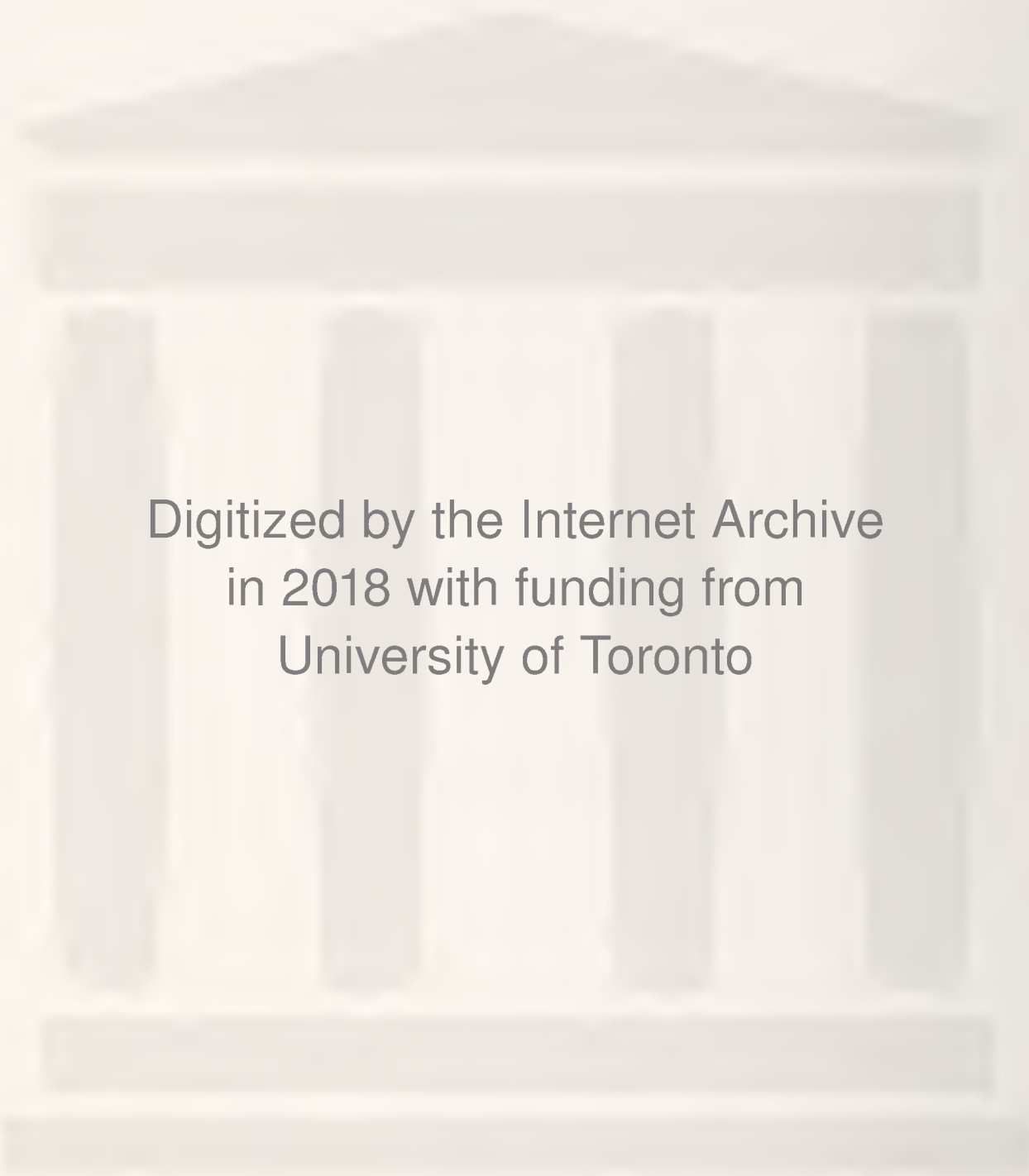
# **INTERNATIONAL TAXATION**

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**University of Toronto  
Faculty of Law**

**International Taxation  
Second Term: 2000 / 2001**

**J. Scott Wilkie**

**Course Outline**

**Course Objective**

- To examine the Canadian tax principles and rules that address movements of capital into and out of Canada. “International taxation” may be understood as the system of domestic tax law provisions that apply to transactions, relationships and other arrangements that have an international dimension and, in result, give rise to the possibility of competing tax claims of more than one jurisdiction.
- To examine the manner in which Canada, and other countries, define the portion of their domestic tax base that is attributable to or reflects the influence of economic arrangements in other jurisdictions and, consequently, accommodate the tax claims asserted by other jurisdictions.
- To consider the ways in which Canada’s and other tax systems interact or conflict with each other in light of the principles and tax provisions discussed in connection with the first two objectives.
- To consider contemporary examples of important international tax policy and legislative developments and their influence on actual transactional situations.

**Materials and Course Format**

- Casebook
- Income Tax Act (Canada)
- Supplemental readings assigned from time to time with respect to particular subjects.
- Instructor notes, which will be distributed throughout the term.

Although the course will be conducted in a traditional lecture format, students will be expected to participate in discussion during the weekly sessions.

## Evaluation

- Evaluation will be by way of an examination at the conclusion of the term, during the normal examination period. It will consist of several questions, designed to evaluate students' understanding of the principles of taxation associated with "international tax rules". At least one question will require discussion of the conceptual significance of these rules. The balance will be in a typical problem format. While prepared by a different instructor, examinations from previous years provide an indication of what likely will be expected. Students will be permitted to use course materials and their notes during the examination; external materials, such as library resources may not be used either directly or in copied form.
- Throughout the terms, examples or problems may be assigned for illustrative purposes. While these will not be graded assignments, they are intended to provide a concrete focus for discussions of the subjects of this course. Students will be expected to have considered these examples or problems in preparation for the course session to which they relate.

## Instructor Information

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Meetings about the course can be arranged either at my office or the law school at students' convenience.



## **A. INTRODUCTION TO “INTERNATIONAL TAX”**

### **1. OBJECTIVES OF INTERNATIONAL TAX POLICY AND INTRODUCTION TO INTERNATIONAL TAX CONCEPTS**

**1.1** What Does “International Tax” Mean?

**1.2** Basic Concepts and Glossary

**1.3** (a) Criteria for Evaluating International Tax Rules

(b) Capital Export Neutrality

(c) National Welfare Neutrality

(d) “Subsidiarity” or National Tax Sovereignty

**1.4** Incorporation of Principles in Tax Legislation

**1.5** The Multinational Corporation and International Business

### **2. SIGNIFICANCE OF INTERNATIONAL TAX CONCEPTS**

**2.1** International Capital Flows

**2.2** (a) Jurisdiction to Tax

(b) “Source”

(c) Residence

(d) Nexus

(e) Income Measurement

**2.3** “Harmful Tax Competition”

**2.4** Electronic Commerce

**2.5** International Tax Avoidance

**2.6** Personal, Corporate Migration

### **3. THE TAXPAYER: CONTEXT FOR “INTERNATIONAL TAX RULES”**

**3.1** (a) International Investment

(b) Allocation of International Tax Base

- (c) Economic Claim

### 3.2 Reduce “International Tax” Cost

- (a) Location of “Income”/Income Earning Activity
- (b) Avoid Multiple Taxation

### 3.3 Taxing Residents

- (a) Taxpayer Objectives
- (b) Tax Efficiency

### 3.4 Taxing Non-residents

- (a) Connection to Jurisdiction

## B. THE CANADIAN LEGISLATIVE FRAMEWORK

## 4. SYSTEMS FOR TAXING RESIDENTS AND NON-RESIDENTS

- ### 4.1
- (a) *Income Tax Act* (Canada) and Tax Treaties
  - (b) Allocate International Tax Base

- ### 4.2
- (a) Limits on International Tax Jurisdiction
  - (b) International Law
  - (c) Constitutional Law

### 4.3 Income Tax Act: Parallel Systems

### 4.4 System for Taxing Residents

- (a) Business vs. Property Income
- (b) “World-wide” Income
- (c) Neutrality Issues

### 4.5 System for Taxing Non-residents

- (a) Business vs. Property Income
- (b) Territorial



- (c) Neutrality Issues

#### **4.6 Treaties**

- (a) Allocate International Tax Base
- (b) Avoid Double Taxation
- (c) Avoid International Tax Avoidance
- (d) Mechanism for Resolving International Tax Disputes

### **5. ASSERTING TAX JURISDICTION**

#### **5.1 Source vs. Residence**

ITA §§ 2(3), 248(28)

#### **5.2 Personal Jurisdiction**

- (a) Individuals
- (b) Corporations
- (c) Other – Trusts, Partnerships

#### **5.3 Residence: Individuals**

ITA §§ 250(1)

- (a) Measure Connection to Jurisdiction
- (b) Distinguish from other connective measures: citizenship, domicile
- (c) Basic jurisdictional tests in Income Tax Act and Treaties
  - (i) OECD Model Tax Convention, Article 3
  - (ii) Measure Closest Jurisdictional Connection
- (d) Legislative tests for Visitors (“Sojourners”) and Certain “Continuing Residents”
- (e) “Ordinarily resident”
  - ITA §§ 250(3)
- (f) Factors

Revenue Canada, IT-221R2

- (g) Part-time Residents
- (h) Overseas Employment Tax Credit

ITA § 122.3

- (i) Dual Residence

#### **5.4 Residence: Corporations**

- (a) “Central Management and Control”
- (b) Statutory Rules

ITA §§ 250(4), (5) and (5.1)

- (c)
  - (i) Dual Residence
  - (ii) Corporate Continuation
  - (iii) International Shipping Corporations

ITA §§ 250(6)

- (d) Basic Jurisdictional Tests in Income Tax Act and Treaties
  - (i) OECD Model Tax Convention, Article 3
  - (ii) Measure closest jurisdictional connection

#### **5.5 Residence: Trusts**

- (a) General Law
- (b) ITA § 94

#### **5.6 (a) Part Year Residence**

ITA § 114

- (b) Changing Residence
  - (i) ITA § 128.1
  - (ii) Short Term Individual Residence
  - (iii) Double Taxation Relief
  - (iv) Special Foreign Tax Credit

- ITA §§ 126(2.21), (2.22)
- Tax Treaty Renegotiations

## **6. SOURCE OF INCOME**

### **6.1 Meaning and Significance of “Source”**

- (a) Geographical source
- (b) Income Quality
- (c) Foreign Tax Credit
- (d) Income Allocation Among Competing Jurisdictions

### **6.2 Periodic Income From Capital**

- (a) Interest, Dividends, Rent, Royalties
- (b) Income From the Sale of Property

### **6.3 Real Property**

### **6.4 Personal Property Not Produced By Taxpayer**

### **6.5 Personal Property Produced By Taxpayer**

### **6.6 Personal Services**

### **6.7 Related To Property Produced/Sold By Taxpayer**

### **6.8 Know-how**

### **6.9 Foreign Exchange**

- (a) ITA §§ 39(2); 95(2)(f), (g)
- (b) Revenue Canada IT-95R
- (c) Character and Timing

## **7. NATURE OF “BUSINESS PRESENCE”**

### **7.1 (a) Electronic Commerce**

- (b) Advertising, Invitation to Treat
- (c) Contracts
- (d) Delivery Mechanisms

- (e) Physical Presence in Jurisdiction (Through Third Party Facilities)
- (f) Nature of Property – Typical vs. Digital

## 7.2 Treaty Rules

## 7.3 Specific Source Rules

## 7.4 *Income Tax Conventions Interpretation Act*

# C. **INTERNATIONAL TRANSACTIONS WITHIN MULTINATIONAL CORPORATE GROUPS**

## 8. **SIGNIFICANT TAX ISSUES**

### 8.1 The Multinational Corporation

### 8.2 International Income Measurement Income Allocation

### 8.3 (a) Reporting International Transactions

#### (b) Types of International Transactions

#### (c) Global Trading

#### (d) Goods and Services

#### (e) Intangible Property

### 8.4 Cost Sharing

### 8.5 Adjudication of International Income Allocations

### 8.6 Competent Authority

### 8.7 APAs (“Advance Pricing Agreements”)

## 9. **TRANSFER PRICING**

### 9.1 International Context

### 9.2 OECD Model Tax Convention – Article IX

### 9.3 “Arm’s Length”

### 9.4 Objectives of Transfer Pricing Rules

- (a) ITA § 247 and Revenue Canada Information Circular IC 87-2R
- (b) Arm's Length Terms and Conditions
- (c) Arm's Length Transactions, Transactional Recharacterization
- (d) Documentation
- (e) Penalty
  - (i) Income adjustments
  - (ii) Computation
  - (iii) Relief - Documentation

### **9.5 Transfer Pricing Analysis**

- (a) Typical Methods: "Comparable Uncontrolled Price", Cost Plus, Resale Minus
- (b) Transactional Profit Analysis: Profit Splits and "Comparisons": "Transactional Net Margin Method"
- (c) Cost Sharing
- (d) Methodological Hierarchy
- (e) Entity vs. Branch

## **D. TAXATION OF NON-RESIDENTS: INBOUND INVESTMENT**

### **10. SYSTEM DESIGN**

#### **10.1 ITA §§ 2(3), 253**

- (a) Direct Income Earning Activities
- (b) Passive Supply of Capital to Residents

#### **10.2 Statutory Framework**

- (a) Direct: ITA §§ 2(3), 115, 118, 253
- (b) Employment
- (c) Carrying on Business

- (d) Disposition of “Taxable Canadian Property”

### **10.3 Employment**

### **10.4 Business Income**

ITA §§ 2(3), 253

- (a)
  - (i) “Carrying on”, “in”, “with”
  - (ii) Relevance of “agency”
  - (iii) Canadian financial advisors

- (b) Branch Tax

ITA § 219

- (c) Foreign Bank Branch Proposals

- (i) Assimilation to Canadian Subsidiary
- (ii) Neutrality issues

### **10.5 Thin Capitalization - ITA §§ 18(4) – (6)**

### **10.6 Converting Branch to Subsidiary/Subsidiary to Branch - ITA §§ 219, 219.1 – ITA §§ 69, 85 (special real property rule)**

### **10.7 Migration Rules: ITA § 128.1 and § 115**

### **10.8 Distributions**

- (a) Return of capital
- (b) Dividend

### **10.9 Non-resident investment corporations**

ITA §§ 133

### **10.10 Tax avoidance**

### **10.11 Taxable Canadian property**

ITA § 115

- (a) Canadian Business Assets
- (b) Unlisted Shares of Resident Canadian Corporations



- (c) Unlisted Shares of Foreign Corporations with Substantial Canadian Real Estate Holdings
- (d) Listed Shares of Resident and Non-Resident Corporations
- (e) Rights and Interests, ITA §§ 115(3)
- (f) Reporting Obligations
  - (i) ITA § 116, 150(1)(a)
  - (ii) Treaty Rules
- (g) Common International Allocation “Conventions”
  - (i) Example: *Canada-United States Income Tax Convention*, Article XIII
  - (ii) Canadian “Departure Tax”, ITA § 128.1

## **11. NON-RESIDENT WITHHOLDING TAX**

### ITA Part XIII

#### **11.1 Management fees**

#### **11.2 Interest**

#### **11.3 Rent**

#### **11.4 Royalties**

#### **11.5 Dividends**

#### **11.6 Trust income**

#### **11.7 Surplus stripping**

ITA § 212.1

#### **11.8 Non-resident to Non-resident**

ITA §§ 212(13), (13.2)

#### **11.9 Income attributable to Canadian business presence of non-resident**

ITR § 805

#### **11.10 Payment and Administration**

ITA § 215

### 11.11 Exceptions For Interest

ITA ¶ 212(1)(b)

### 11.12 Treaty limitations

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- (b) Dividends
- (c) Royalties
- (d) Pensions

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## **12. SYSTEM DESIGN**

- 12.1 Double Taxation
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- 12.3 Unilateral vs. Bilateral Solutions
- 12.4 Relevance of Type of Income
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  - (b) “Foreign Direct Investment”
- 12.6 Passive (Portfolio) Income

## **13. DIRECT INCOME EARNING ACTIVITY**

- 13.1 Foreign Tax Credit: ITA § 126
  - (a) Over-riding Limitations
  - (b) Geographic

- (c) Type of Income
- (d) No Economic Profit
- (e) Short-Term Securities Acquisitions
- (f) Migration

### **13.2 Non-Business income Tax: ITA §§ 126(1)**

- (a) Typically, Withholding Tax
- (b) Rate Limitation
- (c) Federal, Provincial Tax Credit
- (d) Deduction For Tax Not Creditable

ITA §§ 20(11), (12)

### **13.3 Business Income Tax: ITA §§ 126(2)**

- (a) Calculation
- (b) Carryover
  - (i) Deduction for tax not creditable
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ITA §§ 20(11), (12)

- (iii) ITA §§ 110.5 and 111(8)

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#### **16.5 Proposed Foreign Trust Rules**

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### **17.1 (a) System Design and History**

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#### **(b) Territorial Business Taxation**

#### **(c) Foreign Tax Credit Regime**

#### **(d) Anti-Avoidance Regime For Passive Income**

### **17.2 “Foreign Affiliate”**

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### **17.5 Taxation of Dividends: Foreign Tax Credit**

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### **17.6 Foreign Group Reorganizations**

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**21.1** Model Tax Treaties

(a) United Nations

(b) OECD

(c) United States

(d) Canada

**21.2** (a) Treaty Structure

(b) Functions

(i) Jurisdictional

(ii) Allocative

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(c) Tax Avoidance

- (d) Double Taxation

### **21.3 Typical Tax Treaty Provisions**

- (a) Residence
- (b) Permanent Establishment/Business Profits
- (c) Real or Immovable Property
- (d) Shipping and Air Transport
- (e) Associated Enterprises (Transfer Pricing)
- (f) Dividends
- (g) Interest
- (h) Royalties
- (i) Gains
- (j) Independent Personal Services
- (k) Dependent Personal Services
- (l) Artistes and Athletes
- (m) Other Income
- (n) Non-Discrimination
- (o) Competent Authority
- (p) Foreign Tax Credit

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### **22.1 OECD Commentary**

### **22.2 Particular Issues**

### **22.3 Electronic Commerce**

## **23. TAX AVOIDANCE**

### **23.1 Limiting Treaty Benefits**

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### **23.3 Significance of Domestic Anti-Avoidance Legislation**







University of Toronto

International Taxation  
Second Term, 2000-2001

J. Scott Wilkie

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- “Is National Tax Policy Viable in the Face of Global Competition?” by Jack M. Mintz – Special Reports – Tax Notes International July 5, 1999
- Congressional Documents “JCT Reports on International Taxation” – Tax Notes International July 5, 1999
- “Harmful Tax Competition: An Emerging Global Issue” Synthesis and Summary of Recommendations – OECD
- Scope of the Reports – Committee on Fiscal Affairs
- Information Circular 73-10R3 – Tax Evasion
- *Craven (Inspector of Taxes) v. White and Related Appeal*
- *Shell Canada Limited v. The Queen*, [1999] FTR 33199
- *Irving Oil Limited v. The Queen*, [1988] 1 C.T.C.
- *The Queen v. Irving Oil Limited*, [1991] CCH

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- “Source v. Residence-Based Taxation in the European Union: The Wrong Question?” by Richard M. Bird and J. Scott Wilkie
- “Internet Sales Pose International Tax Challenges” by Peter A. Glicklich, Sanford H. Goldberg and Howard J. Levine – Journal of Taxation, June 1996
- “International Initiatives of Electronic Commerce”  
–Electronic Commerce and Canada’s Tax Administration
- “Implications and Risks for Canada’s Tax Administration”  
–Electronic Commerce and Canada’s Tax Administration
- OECD: Current Issues – The 2000 Update
- Technical Advisory Group on Treaty Characterization of E-Commerce Payments – Revised Document for Comments – September 1, 2000
- “International Tax Policy Directions: Some Thoughts on Recent Canadian Experience” by J. Scott Wilkie and Robert Raizenne

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- IC 87-2R - International Transfer Pricing
- “Canadian Transfer Pricing Rules Keep Pace with International Developments” by J. Scott Wilkie – The Tax Executive March-April 1998
- *Specialty Manufacturing Limited v. The Queen*, 99 DTC

**TAXATION OF NON-RESIDENTS: INBOUND INVESTMENT**

- Interpretation Bulletin IT-221R2 – Determination of an Individual’s Residence Status
- “Taxation of International Portfolio Investment” – International Issues in Taxation: The Canadian Perspective
- Information Circular IC 76-12R4 – Applicable Rate of Part XIII Tax on Amounts Paid or Credited to Persons in Treaty Countries
- Information Circular IC 77-16R3 – Non-Resident Income Tax
- Interpretation Bulletin IT-420R3 – Non-Residents – Income Earned in Canada

- Interpretation Bulletin IT-447 – Resident of a Trust or Estate
- Interpretation Bulletin IT-221R2 – Determination of an Individual's Residence Status
- Information Circular IC 72-17R4 – Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada – Section 116
- “Non-Resident Withholding Tax: Corporate Obligations” by J. Scott Wilkie
- “Taxable Canadian Property” by Robert Raizenne and Angelo Nikolakakis

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- “International Taxation – Current Issues” – Canadian Tax Foundation
- Interpretation Bulletin IT-497R - Overseas Employment Tax Credit
- Interpretation Bulletin IT-270R2 - Foreign Tax Credit
- Interpretation Bulletin IT-506 - Foreign Income Taxes as a Deduction from Income
- “Methods for Prevention of Double Taxation” - Cyprus Convention
- “The Taxation of Controlled Foreign Corporations: An International Comparison” by Brian J. Arnold
- “The Foreign Affiliate System in View and Review” by J. Scott Wilkie, Robert Raizenne, Heather I. Kerr and Angelo Nikolakakis
- “Taxing Foreign Business Income” by Nick Pantaleo and J. Scott Wilkie
- *The Queen v. Canada Trustco Mortgage Company*, 99 DTC
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- *Canada Trustco Mortgage Company v. M.N.R.*
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- “Are Tax Treaties Necessary?” by John F. Avery Jones
- “Interpretation of Treaties” – Vienna Convention of the Law of Treaties, May 23, 1969
- “The Interpretation of Tax Conventions in Canada” by Stephen R. Richardson and James W. Welkoff
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- “A Resident of a Contracting State for Tax Treaty Purposes: A Case Comment on Crown Forest Industries”
- “The Interpretation of Tax Treaties With Particular Reference to Article 3(2) of the OECD Model – I”
- “Interpretation of Tax Treaties – A Case Study” by Peter Sundgren
- “International: A Model Tax Treaty for the Asian-Pacific Region? (Part I)” by Richard J. Vann
- “Abuse of Tax Treaties” by David A. Ward, Q.C.
- *Kubicek Estate v. The Queen* [1997] DTC
- *The Attorney General of Canada v. Kubicek Estate* [1997] DTC
- *Cudd Pressure Control v. The Queen* [1998] DTC
- “Converging Tax Systems: Free Trade, International Tax Neutrality and Non-Discrimination” by J. Scott Wilkie